IN THE STATUTORY TRIBUNAL, FIJI ISLANDS
SITTING AS THE TAX TRIBUNAL

Income Tax Appeal No 7 of 2011
Income Tax Appeal No 8 of 2011
Income Tax Appeal No 9 of 2011

BETWEEN: **Three Holding Companies**

Applicant

AND: **Fiji Revenue & Customs Authority**

Respondent

Counsel: **Ms A Low instructed by Mr P Knight of Cromptons Lawyers for the Applicant.**
Ms I Ratuvuku, FRCA Legal Unit, for the Respondent

Date of Hearing: **Tuesday 21 August 2012**
Wednesday 22 August 2012

Date of Judgment: **24 September 2012**

JUDGMENT

DEFINITION OF INCOME – Section 11 Income Tax Act (Cap 201) – Disposition of Shares.

Background

1. These are applications for review made by three Hong Kong holding companies.

2. The three companies have separately been assessed by the Respondent, as having derived income for the purposes of Section 11 of the Income Tax Act (Cap 201), as a result of the disposition of their share ownership in a listed Fijian company.

3. The sell down of those shares, took place at several stages and for various reasons, during the period 2001 to 2008.

4. The origin of the listed company in question ("Company AB") and the history of the Hong Kong companies the subject of this present application, are of critical importance to the issues in dispute.

5. The chronology of events that gave rise to the share disposition, has at least in a short-hand form, been provided by the Applicants in the document entitled, '*Appellants' Chronology of Events*'.

6. The parties have also prepared a Statement of Agreed Facts, that in all cases, save for one share transfer, rely on the same factual backdrop that sets out the history of the issues.

7. For the purposes of setting the scene to this analysis, I will summarise that history as follows:

- Two brothers (Brother A and Brother B) established a family business in Fiji in the early 1930's, under the trading name Brothers AB & Co.

- In 1972, that business was incorporated as Brother A Limited and by the 1980's, was operating through five companies, which in turn were owned in different percentages and controlled by Brother A and his four sons.

- Brother A, his four sons and their family members migrated to New Zealand in 1988.

- The four sons in turn established four New Zealand holding companies, to house their respective interests in the five Fijian companies that ran Brother A Ltd. In addition, Brother A himself (the father of the four sons) held a 52% interest in one of those companies.

- Later, the four brothers established four Hong Kong Holding Companies, purportedly "as an unexceptional way of dealing with New Zealand tax issues".[1]

- In 1999, the five Fijian operating companies were restructured and a new incorporated entity emerged (Company AB).

- Company AB acquired the retailing and wholesaling merchandise business, including all business assets of the Fijian operating companies. Two of the five operating companies essentially held the entire interest in Company AB.

- Those two operating companies were for all intents and purposes owned in equal share by the four brothers through their individual holding companies.[2]

- On 10 June 1999, to ensure that the family continued to maintain effective control over the affairs of Company AB, a management agreement was entered into between the Company and a partnership of the four brothers.[3] That partnership appears to have been established in New Zealand.[4]

- The terms of that Management Agreement were 15 years, plus a further option of 15 years.

- On 10 April 2000, shares held by the four NZ Holding Companies in Company AB were transferred to the four Hong Kong Holding Companies.

- In August 2000, it was decided to wind up the five Fijian operating companies.

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1 See Statement of Agreed Facts (No 7 of 2011) at Para 10. Why both parties would see this as "unexceptional" is quite intriguing.

2 Except in the case of Brother 4 who only held 13,000 shares, rather than 29,000 in one of the Fijian operating companies.

3 At its formation it is unclear whether it was established as a partnership of the holding companies or by the brothers individually.

4 It remains unclear at what exact stage and by what means the partnership of these 4 brothers, apparently converted itself to a partnership formed by four holding companies, however the Option Agreement that was later entered into by the holding companies and another entity, is evidence of the fact that some further conversion or translation of interests took place.

- As a result of the liquidation of two of those companies, the Hong Kong Holding Companies received shares in Company AB by way of distributions in specie.

- Company AB was listed on the South Pacific Stock Exchange in July 2001, with 30,000,000 shares.

- Consistent with Government policy and the share liquidity rule, 10% of the shares needed to be made available through public acquisition and this sell down took place between July and September 2001.

- A further quantity of shares was made available to key suppliers and employees[5] during the period 4 February 2002 to 26 November 2002.[6]

- In April and May 2003, a further interest in the company was released by the Holding Companies, by way of share sales.

- In July 2004, all 373,000 remaining shares held by one of the Hong Kong Holding Companies, was transferred to the other three companies, upon the retirement of one of the four brothers.

- On 14 April 2008, the remaining three Hong Kong Holding Companies disposed of their shares in Company AB, that saw a sale of 4,983,500 shares.

8. On 3 July 2009, Notices of Assessment were issued by the Respondent for the Income Years Ending 31 December 2001, 31 December 2002, 31 December 2003 and 31 December 2008, against the remaining three Hong Kong Holding Companies.

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[5] No detail has been provided in relation to the number of employees engaged by Company AB, nor the number of employees who took up any offer, though as the Annexure "O" to the Agreed Statement of Facts reveals, this number could not have been many.

[6] In all, a total of 493,167 shares.

9. Objections to these Assessments were made by the taxpayers by letter dated 31 August 2009 and a response to that objection letter (referred to as the Objection Decision) was made by the Authority on 9 June 2011.

10. There are several reasons set out within the Authority's Objection Decision, in support of its position, including:-

(i) The companies had made many share transactions and that the large number of shares traded and the frequency of share dealing within the seven year period, indicates that they are "dealing in shares" within the meaning of Section 11(a);

(ii) That the motive and object of the whole transaction was to buy on a short term basis with the view to its resale at a profit;

(iii) The Hong Kong Holding Companies acquired shareholdings without paying any cash, but when the company was listed, shares were sold and cash exchanged. The profit derived from the dealing of shares is subject to income tax under Section 11(a) of the Income Tax Act;

(iv) That the four Hong Kong companies will not be taxed on all the share proceeds received from Fiji and that this could be a scheme set up to avoid paying tax in both tax jurisdictions where the four companies were set up.

11. The taxpayers have appealed against this decision by Application for Review, dated 8 July 2011.

The Case of the Applicant Taxpayers and Application for Review

12. The Applicants cases are comprehensively set out within three separately filed Applications for Review.

13. Extracted from those Applications, the following arguments can be isolated:-

- The Applicants were not in the business of share trading;
- The Applicants did not acquire the shares for the dominant purpose of resale; and
- That in any calculation of income, the cost base of the shares, must be determined having regard to the market and not the par value, so as to avoid double taxation.

Commencing Point for Analysis

14. In *Taxpayer A v Fiji Revenue & Customs Authority*[7], this Tribunal has expressed the way by which Section 11 of the Income Tax Act (201) needs to be interpreted.

15. The focus of Section 11, must be initially, the definition of total income and the description of all sources of income, as provided for within that Section.

16. That must be the starting point for any analysis.

17. What needs to be ascertained in the case of each taxpayer, is what is the basis or the characterisation of the income identified within the Notices of Assessment.

18. It is after that starting point, where the clarifying examples provided for within Section 11(a) of the Act, provide further assistance.

Is the Income that Has Been Assessed, Profit or Gain Accrued or Derived from the Sale or Other Disposition of Personal Property or Any Interest Therein?

19. It is accepted between the parties, that shares are personal property. It is also quite clear from the submissions, that the shares in Company AB, were disposed of by the holding companies that represented the interest of the three families.

[7] [2012]FJTT3

20. There is no doubt there has been profit derived from the sale or other disposition of the personal property.

Does the Business of the Taxpayers Comprise Dealing in Such Property?

21. Section 2 of the Income Tax Act provides a non-exhaustive definition of the terms "dealing in property" and dealing in real and personal property".

22. Several questions emerge. The first being, what is the business of the taxpayers? To my mind the business of the taxpayers can be well understood by considering the activities that are set out within the Management Agreement[8], ostensibly put in place in June 1999, by the interests of the New Zealand Holding Companies,[9] later converted into the interests of the Hong Kong Holding Companies.[10]

23. Clause 1 of that Agreement makes it quite clear that at least from 1 April 1999, the partnership had and could affect supervisory control over the

- The management of all affairs of the Company (Company AB);
- The management of each asset business and investment of the Company;
- The drawing of all cheques and the making of all payments of whatever nature in respect of any and all business(s) [sic} of the Company;
- The execution, implementation and/or termination of each and every contract, agreement, arrangement and relationship of the Company;
- The creation, settlement, extinguishment and compromise of any debts, liabilities, claims of or against the Company.

24. On that basis, the business of the taxpayers can be said to be operating the business of Company AB.[11]

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8 Annexure D to the Statement of Agreed Facts (Case No 7 of 2011)

9 Even though it is acknowledged that the partnership is only represented by four individuals as signatories to that Agreement at that time.

10 So much was supported by the submissions of Counsel for the Applicants.

11 Even if this did not take formally until April 2000, when the New Zealand Holding Companies transferred their interest into the Hong Kong Holding Companies.

Does the Business of the Taxpayers Comprise Dealing in Such Property ?

25. It would seem that the short answer to that question is clearly yes.

26. I form this view based on the following evidence.

27. Firstly, the Management Agreement between Company AB and the partnership of AB and Co dated 10 June 1999, appears to give 'carte blanche' to the taxpayers, to deal with the assets, business and investments of the company as they see fit.

28. Strategic choices to acquire or dispose of shares seem to fit well within the business of the taxpayers. It is here that the initial partnership appears to have been entered into by the four family members, representing the interests of each holding company. [12]

29. Secondly, there is the Option Agreement that was entered into by the then three dominant shareholders on 26 March 2008, prior to the disposal of the shares in April 2008.[13] At some point it would seem, the four brothers (as partners in their own right or as representatives of the New Zealand Holding Companies) transferred their respective interests as partners of the partnership.[14]

30. In the absence of any other evidence to the contrary and given the June 1999 Agreement was a 15 year plus 15 year contractual arrangement, it can only be assumed that these three companies in their former forms,[15] were the original signatories to that agreement.

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[12] The fact that the 1999 Agreement has the bare signatures of the four brothers as individuals, gives the impression of a partnership of individuals, whereas the latter Option Agreement, reveals in fact that the partnership is in fact a partnership of four Hong Kong Holding Companies.

[13] See Annexure to the Affidavit of Mr SB dated

[14] See particularly Recital C of the Option Agreement dated 26 March 2008, between the taxpayers and the then prospective purchaser of the shares the taxpayers held in Company AB. .

[15] Even if this is wrong, it makes only a few months' difference to the analysis.

31. Next is the Option Exercise Note that was issued under the terms of the Option Agreement, by the purchaser of the shares in Company AB on 22 October 2009.

32. This is clearly directed at the taxpayers.

33. Finally, is the Technical Consultancy Agreement entered into between the retailing arm of the newly acquired Company AB and another entity, ostensibly facilitated by the three holding companies.[16]

34. In this regard the Affidavit of Mr SB dated 5 September 2012 is quite revealing.

35. Within the independent advice circular prepared on behalf of Company AB in relation to the partial takeover offer made on 27 March 2008, Mr SB was described as follows:

> *As Chairman, Mr (SB) is not only responsible for implementing the long term growth of the company, but also for overall management and administration. He has been with the company for 30 years.*[17]

36. Yet remarkably, Mr SB states within his Affidavit, in relation to why the Novation Agreement came about:

> *The Partnership entered into a Novation Agreement with (the purchaser) to give effect to the exercise of the option, I am not sure why things were done this way. It was what the lawyers recommended.*

37. And in relation to why the further consultancy agreement was struck:

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[16] It is quite disappointing that no effort has been made by the Appellants to provide more specific details as to who is behind the consulting firm, the party to this Agreement.

[17] See Annexure B of that Affidavit.

The Novation Agreement gave (the purchaser) control over the management of (AB) but they were still having difficulty actually managing the business. For this reason they subcontracted the actual management of the business to a new entity.

38. In relation to the first remarks, I would be very much surprised if the Chairman of a Company with a then recorded turnover of $70million per annum, had no understanding of the process that was set out within the Novation Agreement, particularly given that he initially had been part of a Management Agreement that in effect gives himself, at least in part, a 30 year interest in Company AB

39. But consider the language of that pertaining to why the consultancy agreement was entered into. The suggestion appears to be that following the purchaser exercising its option to buy out the partnership agreement, that it was not able to manage the business and that a new consultancy agreement was required.

40. I simply do not accept that proposition. The purchaser's option under the Novation Agreement was to take effect from 29 October 2009.

41. To make it clear, on 29 October 2009, the purchaser was to assume the management control of Company AB. The buyout price for the extinguishment of that Agreement was $8,300,000.00.

42. Yet the effective date of the new consultancy agreement was 29 October 2009. The purchaser never appeared to have assumed control of the business operations.

43. The later consultancy agreement was to run until 30 June 2015, with a capacity for its extension for an additional 4 year period.

44. Keeping in mind, the initial Management Agreement entered into between the "partners' and Company AB was for a 15 year plus 15 year period, the alternative arrangement still had the effect of giving the partners and whatever interests may exist in whatever form, a possible 20 year management period.

45. The fact that the sale of the taxpayers shares took place in April 2008 and guaranteed them profit from the business for a possible 11 year period, is more than a stroke of good luck. The course of conduct of the taxpayers up and until the time of the sale of the shares and the profit arising from those shares, can only be described as carrying out an undertaking or scheme entered into or devised for the purpose of making a profit.

46. So that there is no mistake, the guiding case law is that found in *Californian Copper Syndicate v Harris* [18], where Lord Justice Clarke has stated:

> *"..enhanced values obtained from realization or conversion of securities may be so assessable, where what is done is not merely a realization or change of investment, but an act done in what is truly the carrying on or carrying out of a business.."*

47. At paragraph 31 of the Appellant's Outline of Submissions, it is argued that all of the disposition of shares lacked any of the essential features which would give them the character of a business deal. Viewed in isolation, that may be the case.

48. But in the context of their inter-relatedness to the management agreement that governed the operation of Company AB and the centrality of that arrangement to the staged disposition of shares, transformed the category of case from being the mere sale of shares, into an act done in the carrying on or carrying out of the business of the taxpayers.

49. For the above reasons, I find that the profit derived from the sales, is therefore income for the purposes of the Income Tax Act (Cap 201).

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[18] (1904) 5 TC 159

How Should the Profit or Gain for Assessments be Calculated?

50. In the Appellant's Further Submissions dated 5 September 2012, the taxpayers flag their challenge to the cost base used by the Respondent for the purposes of the Assessments made.

51. It is argued that FJD 50 cents per share is not the correct cost base to used to ascertain the profit or gain, rather what should be used is the market value of the property at the time of distribution.

52. The Appellants have referenced the cases of *Rangatira Ltd v Commissioner of Inland Revenue*[19] and *Lowe v Commissioner of Inland Revenue* (1981) 5NZTC as authority that assets in question fall to be carried from one account to the other at their market value, on the date of appropriation.

53. It is further argued, that:

> *...The Appellants have paid and accounted for dividend withholding tax on the retained earnings distributed in the liquidation of the Fiji operating companies.*[20]

54. In the case before me, the sale of shares and the conditional manner in which they were released, was part of an undertaking or scheme entered into or devised for purpose of making a profit. In *Rangatira's* case, the matter was nothing other than the realisation of gains made from the sale and disposition of investment shares, otherwise regarded as "trading stock". The case of *Lowe v Commissioner of Inland Revenue,* dealt with the subdivision of land. Even in that case, the Court has made clear, that the computation of profit must frequently be an "inexact exercise"[21].

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19 [1996]UKPC 54

20 See Appellants Further Submissions at Page 3.

21 See Prebble.J, 'Capital Gains From Land Subdivision' in New Zealand Current Taxation, Vol 25, No 11, 1 April 1981.

55. The Appellants submissions are that if the disposition of the shares is viewed to be income for the purposes of the Act, then the shares at acquisition should be valued at the market rate and not the PAR value. Annexure M to the Agreed Statement of Facts in Case no 7 of 2011, provides share prices for period 17 July 2001 to 5 August 2008. Yet there is no evidence of any purchase of the shares. They were not acquired at the nominal market rate.

56. Further, it is argued by the Appellants, that other relevant costs may be taken into account, such as broker fees, accounting costs, valuation costs, other administration and compliance costs. Again, there is simply no evidence of the Holding Companies incurring any costs as part of the distribution of those shares. It is highly likely though, that these costs may have been borne by the Fijian companies at the time of their winding down.

57. In my mind, the method applied was reasonable in the circumstances.

Validity of Assessments

58. The Taxpayers submit that the Assessments made by FRCA in respect of the income years ended 31 December 2001, 2002 and 2003 are invalid because they are issued outside of the statutory timeframes in the now repealed Section 59 of the Act.[22]

59. It is argued that Section 59(1) of the former Act does not apply, because an assessment was issued on each occasion that a tax clearance certificate was issued, or by virtue of the fact that the assessment took place outside of the six year period. The third inter-related argument suggests that the re-opening powers of the Commissioner cannot be enlivened because "the taxpayers were not required under the Act to make a return of income in respect of such amounts".

[22] See Notices of Assessment as they are included in the respective Statements of Agreed Facts.

60. With due respect to such arguments, that is the precise point before me. The Commissioner asserts that the taxpayers did not make a return of income in respect of such amounts. I have found accordingly.

61. Section 55 of the Income Tax Act as it then was, seems quite clear:

> *After examination of the taxpayer's return...or..of the agent's report, the Commissioner shall send or cause to be sent a notice of assessment to the taxpayer stating therein the date by which the amount of such assessment is to be paid.*

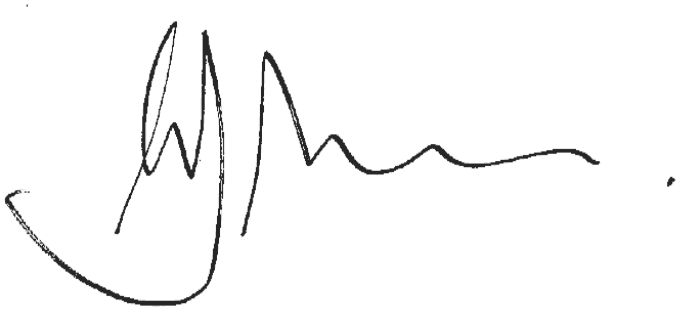
62. It is not a discretion, it is a mandatory requirement imposed by that Section. The Commissioner is required to issue a notice of assessment. I reject the submissions of the Appellants in this regard also.

DECISION OF THE TRIBUNAL

It is the decision of this Tribunal that:-

(i) The Applications be dismissed.

(ii) That the Respondent is invited within 28 days to make application in relation to costs.



Mr Andrew J See
Resident Magistrate